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No. 15-628

In The Supreme Court of the United States

BASSAM YACOUB SALMAN,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR *AMICUS CURIAE* CATO INSTITUTE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Does the personal benefit to the insider that is necessary to establish insider trading under *Dirks v. SEC*, 463 U.S. 646 (1983), require proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature," as the Second Circuit held in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015), or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?

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INTEREST OF *AMICUS CURIAE*[1]

Established in 1977, the Cato Institute is a nonpartisan public-policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies, established in 1989, seeks to restore the principles of constitutional government that are the foundation of liberty. Cato's Center for Monetary and Financial Alternatives was established in 2014 to reveal the shortcomings of today's monetary and financial-regulatory systems and to identify and promote alternatives more conducive to a stable, flourishing, and free society. Toward those ends, Cato holds conferences and publishes books, studies, and the annual *Cato Supreme Court Review*.

This case concerns Cato because it implicates separation of powers, the constitutional right of individuals to receive fair notice of conduct Congress has proscribed, and the functioning of the free market. Cato submits this brief to demonstrate how the Ninth Circuit's misreading of Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange

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[1] Pursuant to Rule 37.3(a), a letter of consent from the respondent to the filing of this brief has been submitted to the Clerk. The petitioner has filed a blanket consent to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no person other than *amicus curiae* or its counsel made a monetary contribution to fund its preparation or submission.

Commission Rule 10b-5 upsets the separation of powers, violates Petitioner's right to fair notice, and threatens market efficiency.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

This Court once observed that, when "deal[ing] with private actions under SEC Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975). The Court's observation is equally true of liability under Rule 10b-5, 17 C.F.R. § 240.10b-5, for insider trading. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), from which Rule 10b-5 derives, does not expressly prohibit insider trading. Instead, this Court's insider-trading decisions have cultivated a judicial oak of their own by defining the circumstances under which insider trading violates Section 10(b)'s amorphous prohibition of securities fraud. *See Dirks v. SEC*, 463 U.S. 646 (1983); *Chiarella v. United States*, 445 U.S. 222 (1980).

As judge-made law, Rule 10b-5's insider-trading prohibition must be interpreted narrowly to avoid separation-of-powers concerns and to ensure that individuals facing potential criminal sanctions have fair notice of what conduct is proscribed. To be illegal under the statute, insider trading must be fraudulent. Trading that is merely unfair is not illegal, and this Court

has resisted the temptation to expand insider trading beyond the perimeters of fraud. *See Dirks*, 463 U.S. at 657 (rejecting argument that "the antifraud provisions require equal information among all traders"). The Ninth Circuit in this case sprinkled the government's fertilizer on the judicial oak to create a mammoth and artificial creation that rests on the ambiguous concept of fairness. *See, e.g.*, Petition of the United States for Rehearing & Rehearing *En Banc* at 23, *United States v. Newman*, 773 F.3d 438 (Nos. 13-1837(L), 13-1917(CON)) (advocating for "fairness (and the perception thereof) in the securities markets."). By upholding the government's expansive interpretation of the personal benefit requirement associated with Section 10(b) and Rule 10b-5, the Ninth Circuit misinterpreted the linchpin linking insider trading to a finding of fraud – the receipt of a personal benefit in exchange for material, nonpublic information – that this Court identified in *Dirks*. The Ninth Circuit crossed the boundary from interpreting the law to writing it and endorsed a dangerous legal scenario in which market participants are denied fair notice of the type of behavior that is proscribed.

By contrast, in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015), the Second Circuit properly interpreted *Dirks*'s personal-benefit element to require proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." *Id.* at 452. That holding is consistent with the familiar understanding of fraud as the use of deception

to receive "something of value." *McNally v. United States*, 483 U.S. 350, 358 (1987), *superseded by statute on other grounds*, 18 U.S.C. § 1346. This Court recognized as much when it held that insider trading is fraud only when the insider "makes 'secret profits'" from trading on or disclosing inside information. *Dirks*, 463 U.S. at 654. The personal-benefit requirement captures those "secret profits" and nothing more expansive.

In conflict with the Second Circuit, the Ninth Circuit below held that a personal benefit exists any time an insider provides material, nonpublic information to a friend or relative, even if the insider receives nothing whatsoever in return. That holding goes beyond the text of Section 10(b) by criminalizing conduct no one would consider fraudulent, and it denies market participants fair notice of what actions are prohibited. The Ninth Circuit's approach would criminalize a vast, unpredictable range of conduct, unconstitutionally requiring investors "to speculate as to the meaning" of Section 10(b) and Rule 10b-5. *City of Chicago v. Morales*, 527 U.S. 41, 58 (1999).

The vagueness of the Ninth Circuit's holding is particularly harmful in the context of securities markets, where investors need clear standards by which to measure their conduct. When outside investors trade in a company's securities based on rumors, tips, or so-called buzz about the company, they potentially improve market efficiency by revealing additional and sometimes better information about the company's value. Indeed, rumors and tips are so critical to

the functioning of the securities markets that the *Wall Street Journal* devotes the "Heard on the Street" column to them. The Ninth Circuit's decision, which subjects outside investors to an unpredictable risk of criminal liability, will chill beneficial market activity.

The lower court's holding subverts the text and spirit of *Dirks*. The Ninth Circuit nevertheless claimed that this result was dictated by a single, isolated sentence in *Dirks*. *United States v. Salman*, 792 F.3d 1087, 1092-93 (9th Cir. 2015) (holding personal benefit exists where an "insider makes a gift of confidential information to a trading relative or friend" (quoting *Dirks*, 463 U.S. at 664)). That sentence, when placed back in the context from which the Ninth Circuit uprooted it, provides no support for the decision below. The Court should reverse that ruling and return *Dirks*'s "judicial oak" to its proper place in the legal landscape.

ARGUMENT

I. THE NINTH CIRCUIT'S DECISION MISINTERPRETS *DIRKS*

This Court recognized in *Dirks* that "it is essential . . . to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules." 463 U.S. at 664. To provide that guidance, the Court held that a tippee does not violate Section 10(b) and Rule 10b-5 by trading on inside information unless he knows the information originated

with an insider who disclosed it in exchange for a personal benefit. *Id.* at 660-62. The Ninth Circuit below held that an insider receives a personal benefit any time he discloses information to a family member or friend who trades. The Ninth Circuit is mistaken. A fair reading of *Dirks* confirms the Second Circuit's holding that a disclosure to a friend or relative does not satisfy the personal-benefit requirement absent "proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." *Newman*, 773 F.3d at 452.

To be illegal under Section 10(b) and Rule 10b-5, insider trading must "defraud investors." *Dirks*, 463 U.S. at 666 n.27 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)). "[T]he words 'to defraud' . . . 'usually signify the deprivation of *something of value* by trick, deceit, chicane or overreaching.'" *McNally*, 483 U.S. at 358 (emphasis added) (quoting *Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924)). For that reason, an insider does not commit fraud unless he exploits inside information to "make[] 'secret profits.'" *Dirks*, 463 U.S. at 654. *Dirks* makes clear that the personal-benefit requirement exists to capture those fraudulently obtained "secret profits." *See id.* at 663 (giving as examples of personal benefits "pecuniary gain or a reputational benefit that will translate into future earnings"); *id.* at 664 (quoting a commentator describing tipping liability as prohibiting an insider from "in effect selling the information to its

recipient for cash, reciprocal information, or other things of value").

The Ninth Circuit stated that its decision follows from *Dirks*'s "clear holding" that "a gift of confidential information to a trading relative or friend" always involves a personal benefit. *Salman*, 792 F.3d at 1093 (quoting *Dirks*, 463 U.S. at 664). In context, however, *Dirks*'s reference to "a gift" does not expand the meaning of "personal benefit" beyond "secret profits" similar to pecuniary gain. The "gift" language appears as part of a broader discussion of the personal-benefit requirement and describes just one of several "facts and circumstances" that can "justify . . . an inference" of personal benefit. *Dirks*, 463 U.S. at 664. The sentence immediately following the "gift" language clarifies that a gift may indicate a personal benefit when "[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." *Id.* That is, a tip to a friend or relative violates Section 10(b) and Rule 10b-5 only when it is equivalent to the insider already having received "secret profits" by trading on the information himself. That may be true of some disclosures to friends and relatives, but it is by no means true for all. *See Newman*, 773 F.3d at 452-53.

The Ninth Circuit's *per se* approach is hard to reconcile with the SEC's judgment elsewhere that a mere disclosure of inside information between close family members is not always fraudulent. SEC Rule 10b5-2 provides that, under Rule 10b-5, a "duty of trust or confidence" exists between spouses, parents and children,

and siblings. Rule 10b5-2(b)(2), 17 C.F.R. § 240.10b5-2(b)(2): An insider does not commit fraud simply by disclosing inside information to someone with whom she shares a duty of trust or confidence, because she reasonably can expect the recipient of the information to keep it secret. *Cf. SEC v. Yun*, 327 F.3d 1263, 1273 (11th Cir. 2003) ("If the SEC can prove that [a] husband and wife had a history or practice of sharing business confidences, and those confidences generally were maintained by the spouse receiving the information, then in most instances the conveying spouse would have a reasonable expectation of confidentiality. . . ."). In the Ninth Circuit, then, an insider would automatically commit fraud by disclosing material, nonpublic information to her cousin who trades but, under Rule 10b5-2, not by disclosing the same information to her spouse who trades. That makes little sense. A more sensible rule, and the rule *Dirks* requires, is that a tip to anyone – spouse, cousin, friend, or stranger – is not criminal unless it involves "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." *Newman*, 773 F.3d at 452.

II. CONTRARY TO THE NINTH CIRCUIT'S DECISION, THE ELEMENTS OF ILLEGAL INSIDER TRADING MUST BE NARROW AND CLEAR

The law governing insider trading under Section 10(b) and Rule 10b-5 is almost exclusively judge-made. *United States v. Chestman*, 947 F.2d 551, 572 (2d Cir.

1991) (Winter, J., concurring in part and dissenting in part). Congress and the SEC have never defined illegal insider trading. Instead, they have "left to the courts" the task of deciding, on a case-by-case basis, when insider trading is and is not fraudulent. H.R. Rep. No. 98-355, at 13-14 (1983), *as reprinted in* 1984 U.S.C.C.A.N. 2274, 2286-87. That is a hazardous undertaking. If not done cautiously, it risks upsetting the separation of powers by co-opting Congress's legislative authority. It also risks perpetuating vague, unpredictable standards of liability that do not provide fair notice of what conduct is prohibited, a particularly serious problem when the health of the securities markets depends on market participants having bright-line rules governing their conduct. For those reasons, judge-made law, such as the federal insider-trading ban, must be as narrow and clear as possible. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1110 (1991) (Scalia, J., concurring in the judgment).

The Second Circuit's decision in *Newman*, by tying the personal-benefit requirement closely to Section 10(b)'s prohibition on fraud, satisfies the need to make the elements of illegal insider trading narrow and clear. The Ninth Circuit's decision below, which expands insider-trading liability beyond the text of Section 10(b) and turns every family reunion and Wall Street water cooler into a potential crime scene, does not.

A. The Ninth Circuit's Decision Violates Separation Of Powers By Prohibiting Conduct Outside The Text Of Section 10(b)

The Framers designed a government in which the legislature, rather than the courts, "prescribes the rules by which the duties and rights of every citizen are to be regulated." THE FEDERALIST NO. 78, at 464 (Alexander Hamilton) (Clinton Rossiter ed., 2003). In interpreting the scope of Section 10(b) and Rule 10b-5, this Court has honored the Framers' design by "refus[ing] to allow 10b-5 challenges to conduct not prohibited by the text of the statute." *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994); *see also Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 (1977) ("[T]he language of the statute must control the interpretation of the rule[.]"). The Court has followed the same approach when dealing with insider trading. *See Dirks*, 463 U.S. at 666 n.27 ("[T]o constitute a violation of Rule 10b-5, there must be fraud."); *Chiarella*, 445 U.S. at 233-34 (rejecting "broad" insider-trading liability "absent some explicit evidence of congressional intent"); *cf. United States v. O'Hagan*, 521 U.S. 642, 658 (1997) (approving misappropriation theory of insider trading because it "comports with § 10(b)'s language").

To avoid punishing conduct that Congress did not criminalize, courts must limit insider-trading liability to the fraudulent practices targeted in Section 10(b). *See Welch v. United States*, 136 S. Ct. 1257, 1268 (2016)

("[T]he separation of powers prohibits a court from imposing criminal punishment beyond what Congress meant to enact."). A violation of Rule 10b-5 is a criminal offense that carries a prison sentence of up to twenty years and a fine of up to $5 million, 15 U.S.C. § 78ff(a), and nothing in the text or history of Section 10(b) suggests an intent to prohibit all insider trading, *see* Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 55-59 (1980). In fact, Congress's decision to address insider trading specifically only in the limited circumstances covered by Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b), suggests Congress deliberately chose *not* to enact a broad insider-trading ban in Section 10(b). *See* Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 319 (1981). As the Court emphasized in *Chiarella*, "the 1934 Act cannot be read more broadly than its language and the statutory scheme reasonably permit. Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud." *Chiarella*, 445 U.S. at 234-35 (internal quotation marks and citations omitted).

The Ninth Circuit's decision impermissibly exceeds the text of Section 10(b) by criminalizing conduct no reasonable person would regard as fraudulent. Businesspersons and Wall Street professionals, like everyone else, often have conversations about work with friends and family. They may casually discuss or boast about their jobs in break rooms, bars, or gyms, or on golf courses, softball fields, or basketball courts. In

any one of these conversations, they might disclose inside information. While such loose talk may be careless, no one would call it fraud – except, apparently, the Ninth Circuit. Under the Ninth Circuit's decision, every bit of water-cooler small talk or locker-room braggadocio could give rise to strict criminal liability. Even insiders who disclose information for honorable reasons are at risk. For example, *Dirks* held that an insider who disclosed confidential information to expose a fraud "clearly" did not receive a personal benefit. 463 U.S. at 666-67. In the Ninth Circuit, that same insider, acting with the same innocent purpose, could be a criminal if he disclosed the information to a relative instead of a stranger. This bizarre result cannot be squared with the text of Section 10(b).

B. The Ninth Circuit's Decision Violates Due Process And The Rule Of Lenity By Adopting A Vague, Unpredictable Approach To Illegal Insider Trading

Without a narrow, clear judicial interpretation, Section 10(b) and Rule 10b-5 would be unconstitutionally vague as applied to insider trading. Neither law so much as mentions insider trading; their language "is at best a general authorization to the SEC and to the courts to fashion rules founded largely on those tribunals' judgments as to why insider trading is or is not fraudulent, deceptive or manipulative." *Chestman*, 947 F.2d at 573 (Winter, J., concurring in part and dissenting in part). "Fraud," "deception," and "manipulation" are broad categories with many possible applications.

The "unavoidable uncertainty and arbitrariness of adjudication" inherent in an unconstrained inquiry into whether any given act of insider trading falls within those categories violates due process. *Johnson v. United States*, 135 S. Ct. 2551, 2562 (2015).

This Court in *Dirks* recognized the special risks of uncertainty and arbitrary enforcement posed by applying Section 10(b) and Rule 10b-5 to insider trading. The Court was concerned that, "[w]ithout legal limitations, market participants are forced to rely on the reasonableness of the [government's] litigation strategy, but that can be hazardous." 463 U.S. at 664 n.24. The Second Circuit's rule in *Newman* addresses that concern by limiting insider-trading liability to the familiar bounds of common-law fraud. *Newman*, 773 F.3d at 452 ("[I]n order to form the basis for a fraudulent breach, the personal benefit . . must be of some consequence."); *see McNally*, 483 U.S. at 358-60 (interpreting mail-fraud statute narrowly based on traditional definition of fraud to avoid vagueness). The Ninth Circuit's approach, in contrast, creates countless areas of uncertainty. To take just one example, if tipping a "friend" is *per se* illegal, *Salman*, 792 F.3d at 1093, what type of friend qualifies? Is it enough that the insider and tippee were roommates? *See SEC v. Payton*, 97 F. Supp. 3d 558 (S.D.N.Y. 2015). That they "were alumni of the same school or attended the same church"? *Newman*, 773 F.3d at 452. That the tippee is the insider's longtime barber? *See SEC v. Maxwell*, 341 F. Supp. 2d 941 (S.D. Ohio 2004). The uncertainty only gets worse as

the final tippee becomes farther removed from the insider? What if the insider tips his barber, who tips his wife, who tips her favorite hairstylist? Can the hairstylist trade? There is no way for anyone to know until the government files charges. *See* Transcript of Oral Arg. at 49, *Newman*, 773 F.3d 438 (Judge Parker: "[W]e sit in the financial capital of the world. And the amorphous theory that you have . . . tried this case on, gives precious little guidance to all of these institutions, all of these hedge funds out there who are trying to come up with some bright line rules about what can and cannot be done. And your theory leaves all of these institutions at the mercy of the government. . . .").

Contrary to *Dirks*'s goal of providing clear guidance to market participants, the Ninth Circuit's approach to illegal insider trading "ha[s] no limiting principle." *Dirks*, 463 U.S. at 664. If a personal benefit exists for *any* disclosure to a friend or relative, the ephemeral benefit of feeling happy about helping a friend or relative could itself be a personal benefit. But that theory cannot sensibly be limited to friends and relatives, or to any particular emotion. The insider in *Dirks* disclosed inside information to expose a corporate fraud. 463 U.S. at 667. But suppose a whistleblower were motivated not just by a desire to expose the fraud, but also in part by a desire to punish the corporation's CEO for denying him a promotion. Under the Ninth Circuit's reasoning, the pleasure the whistleblower felt at his successful revenge could land him in federal prison. If that were all it took to transform "clearly" innocent conduct, *see Dirks*, 463 U.S. at 667,

into criminal fraud, "the personal benefit requirement would be a nullity," *Newman*, 773 F.3d at 452.

Finally, if any doubts remain about the proper scope of the federal insider-trading ban, they should be resolved against the Ninth Circuit's decision by "the rule that 'ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity.'" *Yates v. United States*, 135 S. Ct. 1074, 1088 (2015) (quoting *Cleveland v. United States*, 531 U.S. 12, 25 (2000)). The rule of lenity is especially relevant here, where the government's reading of Section 10(b) and Rule 10b-5 could expose individuals to 20-year prison sentences and $5 million fines for saying the wrong thing at a family reunion or birthday party. *See id.* (invoking rule of lenity to avoid "20-year prison sentences" for broad range of conduct). For such severe penalties to be appropriate, traders must have clear notice that their conduct is unlawful. *See Newman*, 773 F.3d at 450 ("[*M*]*ens rea*, which requires that the defendant know the facts that make his conduct illegal, is a necessary element in every crime. Such a [*mens rea*] requirement is particularly appropriate in insider trading cases where we have acknowledged 'it is easy to imagine a . . . trader who receives a tip and is unaware that his conduct was illegal and therefore wrongful.'"). The Court should not construe Section 10(b) and Rule 10b-5 to criminalize the mere sharing of information with friends or relatives when that conduct is not "plainly and unmistakably proscribed," *Dunn v. United States*, 442 U.S. 100, 112-13 (1979) (internal quotation marks omitted), by those laws' antifraud language.

The Court's treatment of a vague anti-corruption law in *Skilling v. United States*, 561 U.S. 358 (2010), is instructive. In *Skilling*, the Court interpreted the federal statute criminalizing "honest-services" wire fraud, 18 U.S.C. § 1346, to avoid due-process and rule-of-lenity concerns. *Id.* at 402-11. Rather than apply the statute in its full "potential breadth," the Court "pare[d]" the statute's application to its "core" purpose of prohibiting bribes and kickbacks. *Id.* at 403-04. "Reading the statute to prohibit a wider range of offensive conduct," the Court held, "would raise the due process concerns underlying the vagueness doctrine" and violate the rule of lenity. *Id.* at 408, 410-11. As in *Skilling*, due process and the rule of lenity require limiting the judge-made insider-trading prohibition to Section 10(b) and Rule 10b-5's "core" of prohibiting securities fraud. "'If Congress desires to go further, . it must speak more clearly than it has.'" *Id.* at 411 (quoting *McNally*, 483 U.S. at 360).

C. The Ninth Circuit's Vague, Unpredictable Approach To Illegal Insider Trading Will Chill Beneficial Economic Activity

In addition to the Ninth Circuit's decision's constitutional problems, the decision will have negative real-world consequences for financial markets. Because "most investors . . . rely on [a] security's market price as an unbiased assessment of the security's value," *Amgen Inc. v. Conn. Retirement Plans & Trust Funds*,

133 S. Ct. 1184, 1192 (2013), it is important that a company's stock price reflect as much information about the company as possible. *See* Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 866 (1983) ("The more accurately prices reflect information, the better prices guide capital investment in the economy."). Confidential information about a company can be revealed to the market in two main ways. First, sources like market analysts and the *Wall Street Journal*'s "Heard on the Street" column can report rumors or information about a company to investors. *See Dirks*, 463 U.S. at 658-59 (discussing analysts). Second, investors who come into possession of rumors or inside information about a company can incorporate their information into the company's stock price by trading. Easterbrook, *supra*, at 327. The Ninth Circuit's decision threatens to chill both of these accepted methods for disclosing information by leaving market analysts and investors with no idea "where the line is between permissible and impermissible disclosures and uses." *Dirks*, 463 U.S. at 658 n.17. Rather than risk prosecution under a vague criminal law, analysts might refrain from disclosing information, and investors might refrain from trading. The result will be less accurate security prices, less informed investors, and less efficient markets.

In *Dirks*, this Court recognized that "market efficiency in pricing is significantly enhanced by [market analysts'] initiatives to ferret out and analyze information" about companies. *Id.* (quoting Raymond L. Dirks, 21 S.E.C. Docket 1401, 1406 (1981)). Analysts'

efforts to gather information from insiders and disclose that information to their clients are "necessary to the preservation of a healthy market" because the "information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities." *Id.* at 658-59. *Dirks* rejected the government's "imprecise" theory of insider-trading liability because, the Court held, the imprecision "could have an inhibiting influence on the role of market analysts." *Id.* at 658 & n.17. The Ninth Circuit's vague approach creates the same problem. Insiders and market analysts will worry that they know each other well enough to qualify as "friends" under the Ninth Circuit's holding. *See Newman*, 773 F.3d at 452 (addressing government's argument that personal benefit existed between analysts who "were not 'close' friends, but had known each other for years"). As a result, insiders will be reluctant to share information with analysts, and analysts will be reluctant to disclose what, if anything, they learn. That information, and its further analysis and aggregation, will remain hidden from the market. *See Chestman*, 947 F.2d at 578 (Winter, J., concurring in part and dissenting in part) (explaining that "a rule commanding equal access [to information] would result in a securities market governed by relative degrees of ignorance").

Even in the absence of market analysts, outside investors who have information or rumors that are not reflected in a company's stock price can move the price closer to its correct value by trading based on their information. More generally, empirical studies confirm

that private information is incorporated quickly into the stock price, even with a small number of informed investors trading. As informed investors' trades begin to move the stock price, the changing price sends signals about the stock's correct value to uninformed investors. The uninformed investors then trade based on those signals, and the stock price ultimately ends up closer to its correct value. *See, e.g.*, Martin Barner et al., *On the Microstructure of Price Determination and Information Aggregation with Sequential and Asymmetric Information Arrival in an Experimental Asset Market*, 1 ANNALS FIN. 1 (2005); Ji-Chai Lin & Michael S. Rozeff, *The Speed of Adjustment of Prices to Private Information: Empirical Tests*, 18 J. FIN. RES. 143 (1995). And by moving the company's stock price closer to its correct value, informed outside investors limit true insiders' ability to profit from their inside information, thereby transferring the value of the information from insiders to the investing public. *See* Henry G. Manne, INSIDER TRADING AND THE STOCK MARKET 60-61, 65, 84 (1966); *see also* Easterbrook, *supra*, at 329-30 ("The informed traders thus protect the uninformed.").

These benefits of trading by informed outsiders are well-recognized. *See* Stanislav Dolgopolov, *Insider Trading*, THE CONCISE ENCYCLOPEDIA OF ECONOMICS (2d ed. 2007), http://www.econlib.org/library/Enc/InsiderTrading.html ("There is little disagreement that insider trading makes securities markets more efficient [in terms of pricing accuracy]."). But under the Ninth

Circuit's holding, outsiders will be hard-pressed to decide which tips or rumors are fair game to trade on and which are not. An investor who hears a rumor about tech stocks from his banker cousin or gets a recommendation to invest in "plastics" from a family friend may well be free to trade – but then again, he may not be, and the consequences of guessing wrong could be dire. Without any way to "be sure when the line [between legal and illegal conduct] is crossed," *Dirks*, 463 U.S. at 658 n.17, the investor might choose not to trade, even when doing so would be both lawful and beneficial to the market. The resulting market harm can and should be avoided by reversing the Ninth Circuit's decision.

CONCLUSION

In *Chiarella*, this Court first rejected the government's attempt to create a broad insider-trading prohibition based on "a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." 445 U.S. at 233. The Court did so again in *Dirks*, "repudiating" the government's argument that Section 10(b) and Rule 10b-5 "require equal information among all traders." *Dirks*, 463 U.S. at 657. Now, more than 30 years after *Dirks*, the song remains the same. The government argues for an expansive insider-trading prohibition, relying not on the text of Section 10(b) and Rule 10b-5 but on an ambiguous concern with "fairness (and the perception thereof) in the securities markets." Petition of the United States for Rehearing & Rehearing *En Banc*

at 23, *Newman*, 773 F.3d 438 (Nos. 13-1837(L), 13-1917(CON)). The government's error is the same as it has always been: Section 10(b) and Rule 10b-5 neither criminalize unfairness nor guarantee equal access to information. They prohibit fraud. *Dirks*, 463 U.S. at 654-58.

The Ninth Circuit's endorsement of the government's position that it can prove illegal insider trading simply by proving that an insider provided confidential information to a friend or relative who trades untethers the elements of this "crime" from the traditional understanding of fraud, replacing the offense Congress enacted in Section 10(b) with a judge-made crime of indeterminate scope. That holding usurps Congress's constitutional authority to define crimes, violates due process by denying market participants fair notice of what conduct is prohibited, and threatens the nation's markets. This Court should reverse.

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